(816) 292-2000 (FAX: (816) 292-2001

Mark Witcher Texas #21820900
AT&T Communications
919 Congress, Suite 1500
Austin, Texas 78701
(512) 370-2010 FAX: (512) 370-2096

Attorneys for AT&T Communications of the Southwest, Inc.

Appendix A

Projection Life Comparisons

Account Number	Account Name	FCC Range Low (a)	High (b)	FCC SWBT MO (c)	PSC SWBT MO (d)	Staff SWBT MO (e)
2112	Motor Vehicles	7.5	9.5	8.0	9.3	9.5
2115	Garage Work Eqpt	12.0	18.0	12.0	14.0	10.8
2118	Other Work Eqpt	12.0	18.0	18.0	17.0	15.2
2121	Buildings	N/A	N/A	47.0	47.0	38.0
2122	Furniture	15.0	20.0	18.0	23.0	15.0
2123.1	Ofc. Support Eqpt	10.0	15.0	11.0	15.0	11.0
2123.2	Co. Comm. Eqpt	7.0	10.0	9.0	9.0	7.9
2124	Gen. Purpose Computers	8.0	8.0	6.5	6.8	6.9
2212	Digital Switching	16.0	18.0	16.0	17.5	9.4
2220	Operator Systems	8.0	12.0	15.0	15.0	13.5
2232	Digital Circuit	11.0	13.0	11.0	15.0	7.0
2351	Public Telephones	7.0	10.0	13.0	13.0	7.8
2411	Poles	25.0	35.0	35.0	38.0	18.4
2421	Aerial Cable - Met	20.0	26.0	25.0	27.8	13.7
2421	Aerial Cable - Fiber	25.0	30.0	25.0	27.8	13.7
2422	Underground Cable - Met	25.0	30.0	25.0	30.0	15.0
2422	Underground Cable - Fiber	25.0	30.0	25.0	35.0	25.7
2423	Buried Cable - Met	20.0	28.0	20.0	28.0	16.3
2423	Buried Cable - Fiber	25.0	30.0	25.0	30.0	20.4
2426	Intrabldg Cable - Met	20.0	25.0	20.0	30.0	19.3
2426	Intrabldg Cable - Fiber	25.0	30.0	25.0	30.0	19.3
2441	Conduit Systems	50.0	60.0	65.0	65.0	52.0

Source: Cols a,b,d = DMB-2
Cols c,d = DMB-4

CERTIFICATE OF SERVICE BY MAIL

A true and correct copy of the foregoing was served upon the parties identified on the attached service list on this 20th day of August 1997, by placing same in a postage paid envelope and depositing in the U.S. Mail.

Paul G. Lane
Diane J. Harter
Leo J. Bub
Southwestern Bell Telephone Co.
100 N. Tucker Blvd., Room 630
St. Louis, MO 63101

Carl J. Lumley
Leland B. Curtis
Curtis, Oetting, Heinz, Garrett & Soule, P.C.
130 S. Bemiston, Suite 200
St. Louis, MO 63105

Stephen Morris
MCI Telecommunications Corporation
701 Brazos, Suite 600
Austin, TX 78701

Michael F. Dandino
Senior Public Counsel
Office of the Public Counsel
P. O. Box 7800
Jefferson City, MO 65102

RECEIVED
SEP - 5 1997
FCC MAIL ROOM

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of AT&T Communications of the Southwest, Inc.'s Petition for Arbitration pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company.	)	Case No. TO-97-40
Petition of MCI Telecommunications Corporation and its Affiliates, Including MCImetro Access Transmission Services, Inc. for Arbitration and Mediation Under the Federal Telecommunications Act of 1996 of Unresolved Interconnection Issues with Southwestern Bell Telephone Company.	)	Case No. TO-97-67

SOUTHWESTERN BELL TELEPHONE COMPANY'S MOTION FOR CLARIFICATION, MODIFICATION AND APPLICATION FOR REHEARING OF FINAL ARBITRATION ORDER

Paul G. Lane
Leo J. Bub
Anthony K. Conroy
Diana J. Harter
Attorneys for Southwestern Bell Telephone Company
100 North Tucker Boulevard, Room 630
St. Louis, Missouri 63101-1796

August 20, 1997

NP

TABLE OF CONTENTS

RECEIVED
SEP - 5 1997
FCC MAIL ROOM

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of AT&T Communications of the Southwest, Inc.'s Petition for Arbitration pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company.	)	Case No. TO-97-40
Petition of MCI Telecommunications Corporation and its Affiliates, Including MCImetro Access Transmission Services, Inc. for Arbitration and Mediation Under the Federal Telecommunications Act of 1996 of Unresolved Interconnection Issues with Southwestern Bell Telephone Company.	)	Case No. TO-97-67

SOUTHWESTERN BELL TELEPHONE COMPANY'S
MOTION FOR CLARIFICATION, MODIFICATION
AND APPLICATION FOR REHEARING OF FINAL ARBITRATION ORDER

Southwestern Bell Telephone Company respectfully requests the Missouri Public Service Commission to clarify, modify and rehear its Final Arbitration Order (Final Order) issued July 31, 1997. This Order adopted and made permanent, without a hearing of any kind, the pricing recommendations for interconnection, unbundled network elements and resold services made by the Commission's Staff following its independent review which began on February 10, 1997.

EXECUTIVE SUMMARY

Southwestern Bell appreciates the investment of time and resources Staff devoted to understanding Southwestern Bell's costing methods and its cost model inputs. As a result of these efforts, Southwestern Bell believes that Staff has a much better understanding of Southwestern Bell's costing process and how it works. The comprehensive review by Staff should be of value to the Commission in this case.

But the procedure adopted for setting permanent rates effectively deprived the parties of their rights to be heard and present evidence before the final determination on rates was made. The Commission did not base its Final Order on a further review of the record it previously compiled in setting interim rates in the Initial Order. Instead, the Commission based its determination on a report prepared by Staff, based on its independent review of data requested from the parties, which was conducted over a period of months after the close of the record on which interim rates were set. Despite having issued an order outlining the procedures to be followed in establishing "permanent" rates (which itself drew criticisms from the parties for departing from the established practice of evidential hearings), the Commission jettisoned the procedural schedule and adopted permanent rates. The process was deficient in (a) failing to permit the parties any review or comment on the Staff proposal prior to adoption, (b) failing to allow the parties to offer their own proposals and evidence concerning costs and prices and (c) failing to conduct on-the-record proceedings with submission of testimony, cross-examination, oral argument and briefing. Cutting off basic procedural rights violates not only state and federal administrative procedural rules, but also fundamental due process rights protected by the Missouri and U.S. Constitutions.

Had Southwestern Bell been permitted to present its views to the Commission, it would have challenged the Staff recommendation in several respects and urged the Commission to adopt prices based on specific, concrete and tested evidence in the record. Most notably, the Commission failed to even consider Southwestern Bell's actual booked or embedded costs of providing interconnection and facilities even though required by Section 252(d)(1) of the Federal

Telecommunications Act of 1996 (FTA) to base prices on the "cost . . . of providing" them.[1] Instead, the Commission accepted in toto all of the rates recommended by Staff, which were based on the hypothetical Total Element Long Run Incremental Cost (TELRIC) method initially imposed on the States by the Federal Communications Commission but struck down by the 8th Circuit Court of Appeals as beyond the FCC's authority.[2] The Commission's use of this method guarantees that Southwestern Bell will not recover its actual cost of providing these facilities to AT&T and MCI, much less the "reasonable profit" that Section 252(d)(1)(B) permits.

Even if the use of forward-looking costs were appropriate to set prices in this context (which they are not), the TELRIC approach Staff employed was improper. Rather than focusing on Southwestern Bell's forward-looking costs in providing interconnection and facilities over its network as it truly exists, Staff adjusted many of Southwestern Bell's cost model inputs (such as fill factors and depreciation) which resulted in the development of prices based on hypothetical, forward-looking costs of a perfectly efficient, latest-technology network -- a network that does not exist, either here in Missouri or anywhere else.

Staff's approach generated interconnection and unbundled network element prices that fall far short of recovering the cost of providing these services. Prices for these unbundled elements

---

[1]The Initial Arbitration Order in this case, In the Matter of AT&T Communications of the Southwest, Inc's Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephones Company, et al., Case Nos. TO-97-40 and TO-97-64, issued December 11, 1996 (Initial Order), was based on costs determined pursuant to the FCC's pricing rules. Southwestern Bell's prefiled testimony reflected this approach, and the Commission did not consider the actual costs of Southwestern Bell's provision of unbundled network elements because Southwestern Bell had no opportunity to present these costs as a result of the FCC mandate.

[2]Iowa Utilities Board v. FCC, 1997 U.S. App. LEXIS 15, 398 (8th Cir. 1997).

are significantly below both Southwestern Bell's actual historical costs and its forward-looking TELRIC costs. While some of these "permanent" rates are clearly an improvement over some of the interim rates previously adopted, the Final Order nevertheless results in prices which unfairly deprive Southwestern Bell of its property and which fall short of statutory requirements. The following table shows the Final Order's impact on a standard 8db loop, local switching per minute of use charge and unbundled transport, three of the more critical unbundled network elements:

	SWBT Actual Cost	SWBT TELRIC Cost	Commission Arbitration Order[3]
Unbundled Local Loop Statewide Average	$28.01	$22.75	$16.88
Unbundled Local Switching Per Minute of Use[4]	$.004909	$.007685	$.003262
Transport Per Minute Minute of Use	$.002576	$.00085	$.00035

(Cooper Affidavit, para. 8, p. 10).

On an unbundled statewide average basis, the Commission-ordered rate of $16.88 for an 8db loop is just 66% of Southwestern Bell's embedded costs that it actually incurs to provide this facility, and recovers only 74% of Southwestern Bell's TELRIC costs (which Southwestern Bell believes is an inaccurate and inadequate measurement of its actual costs). Similarly, the Commission-ordered rate for unbundled local switching would recover only 14% of its actual costs.

---

[3]The rates shown reflect a statewide average weighting the four geographic zones used by the Commission to establish rates.

[4]This category combines the flat rated port charge and the per minute of use switching charge in order to show a true comparison among actual, TELRIC, and Commission ordered switching rates.

The potential financial impact of the Final Order is demonstrated in the attached affidavit of William C. Bailey, Schedule 1, which shows what Southwestern Bell would earn if it provided only network elements at the rates set by the Final Order. The analysis assumes that all retail costs found by the Final Order to be avoidable are in fact avoided, and further assumes that no profit is earned. The remaining costs are then compared to the revenues Southwestern Bell would receive if all of its current customers were served by new competitors which provided service using bundled network elements at the rates set by the Final Order. In that analysis, Southwestern Bell's revenues would be approximately $335 million short of its costs on an annual basis, or the equivalent of $11.79 per customer line per month. (Id., para. 4, Sch. 2, p. 2). No business can operate under such debilitating conditions.

The financial impacts of the unbundled network element rate levels can also be demonstrated on an individual customer level. As shown in Schedule 2 to the attached affidavit of William C. Bailey, AT&T/MCI could rebundle the unbundled network elements at prices far below not only Southwestern Bell's retail rates, but far below the 19.2% wholesale discount rate established in the Final Order. For example, a business customer in Festus taking Metropolitan Calling Area (MCA) and the Works[5] services today pays Southwestern Bell $121.10/month. The discount rate of 19.2% would yield a cost of $97.85 to AT&T/MCI for the same package. But, if MCI/AT&T were permitted to purchase unbundled network elements at the rates set by the Commission, they would pay Southwestern Bell only $30.23 for the entire package, a 75% discount off retail. (Bailey Affidavit, para. 5, Sch. 2). The Commission's Final Order would

---

[5]The Works is a package of the most popular vertical services such as Call Waiting and Three Way Calling.

place Southwestern Bell at an insuperable competitive disadvantage, even though both Southwestern Bell and MCI/AT&T are using Southwestern Bell's network.

The consequences of a decision to impose these rate levels are severe. No incoming local service provider will build a network in Missouri when Southwestern Bell's services and unbundled network elements are available at bargain prices that are far lower than the cost to install a network. Nor will Southwestern Bell be in a position to invest in the network when it literally loses money on that investment. (Bailey Affidavit, para. 3). Moreover, the financial and operational constraints placed on Southwestern Bell will prevent it from competing on equal terms, thereby exacerbating the financial impact of this decision. By creating an environment in which Southwestern Bell will be unable to recover its costs in providing service to its new competitors, the Final Order, if not substantially revised, will cause significant harm to Southwestern Bell's Missouri operations, and to competition. Neither Section 252(d) nor the Missouri and U.S. Constitutions permit rates to be set so low as to cause such a taking of property and a dilution of shareholder investment.

The Final Order also adopted a resale discount of 19.2% on all services other than operator services, for which a discount of 13.91% was adopted. The discount is based substantially on the methodology originally imposed on the States by the FCC which was subsequently declared beyond the authority of the FCC by the 8th Circuit Court of Appeals.[6] The Staff proposal, accepted by the Commission, nevertheless followed the methodology with only minor adjustments. But even as revised, this methodology suffers from at least three distinct flaws. Section 252(d)(3) of the FTA, requires the discount to be determined based on marketing,

---

[6]Iowa Utilities Board v. FCC, 1997 U.S. App. LEXIS 15, 398 (8TH Cir. 1997).

billing, collection and other costs that will be avoided when services are resold. The Commission's approach, however, establishes a standard discount applicable to all services (other than operator services) even though the costs that will be avoided vary substantially on a service-by-service basis. (Smith Affidavit, para. 4.) For example, a heavily advertised and marketed service like Caller ID will have a greater level of avoided costs than a standard local exchange business line. But the aggregate approach adopted by the Commission assumes that costs for two services will be avoided in the same exact percentage. Second, as demonstrated infra, even if an aggregate approach were permissible, the methodology adopted by the Commission improperly assumes that all or most costs in designated accounts will be avoided without any support whatsoever. Third, the Commission's methodology includes conceptual errors that erroneously inflate the percentage of costs which will be avoided. The conceptual errors are based in part on the treatment of operator services. The Commission's Order erroneously considers operator services cost to be avoidable when resellers purchase all services other than operator services. Similarly, the Commission's methodology includes avoidable costs from all services other than operator services in computing the separate discounts for operator services. This approach makes no sense.

BACKGROUND

Since February 10, 1997 Staff, acting in its capacity as advisor to the Commission, conducted an independent ex parte investigation[7] into the parties' cost studies, cost models and

[7]Opposing parties were not permitted to be present when Staff individually met with each of the parties. The parties were also not permitted access to information or materials supplied to Staff by other parties. Order Granting Clarification and Modification and Denying Motion to Identify and Motions for Rehearing, Case Nos. TO-97-40, TO-97-67, issued January 22, 1997, pp. 8-9 (Reconsideration Order)

inputs supporting their respective positions on appropriate prices for interconnection, unbundled elements and resold services. The Commission, after reconsideration of its Initial Order was sought, directed this review because it determined that the "ninety-day time constraint imposed by the Act . . . did not permit the detailed analysis the Commission considers necessary for establishing permanent rates for unbundled elements and resale."[8] Accordingly, the Commission ruled that the rates from its Initial Order would be "interim rates only" and that "further proceedings shall be conducted to establish permanent rates."[9]

Before this review process even began, all parties to this proceeding expressed serious concerns that the procedure outlined in the Reconsideration Order for setting permanent rates did not comport with minimum due process requirements. AT&T and MCI strongly urged the Commission to reconsider the last steps of its proposed permanent price proceeding. They recommended that once Staff and OPC concluded their investigations into the parties' cost models, the Commission should establish a standard hearing schedule with Staff, OPC and the other parties presenting their information on the record and the Commission then making a decision.[10]

Southwestern Bell also urged the Commission to take appropriate steps to ensure that procedural and substantive due process rights were safeguarded. Concurring with AT&T and MCI that the Commission should schedule a hearing after Staff's review, Southwestern Bell

---

[8]Ibid.

[9]Ibid.

[10]Joint Application for Rehearing of MCI Telecommunications Corporation and Its Affiliates Including MCImetro Access Transmission Services, Inc. and AT&T Communications of the Southwest, Inc., Case Nos. TO-97-40 and TO-97-67, filed February 3, 1997, at p. 2.

recommended that the parties should first be required to advise the Commission and the other parties of the rates they believed the Commission should adopt, along with the evidentiary support for those rates. After appropriate notice, the parties should have been given an opportunity to be heard concerning the proposals and evidentiary support of the other parties. Southwestern Bell suggested that the Commission's traditional evidentiary hearing would best accomplish this purpose.[11]

The Final Order, however, ignored these requests. And the "further proceedings" that were promised in the Reconsideration Order never occurred. No party was provided an opportunity -- before the Commission rendered its decision setting permanent rates -- to present its views to the Commission or to test the evidence and conclusions underlying Staff's recommended prices. Southwestern Bell was not permitted to explain its position that an actual cost standard should be utilized, nor was it permitted to demonstrate why its TELRIC studies were appropriate if the Commission decided to require that approach. Nor was Southwestern Bell permitted to challenge the Staff's proposal. No evidence was submitted, no hearing was held, no cross-examination was conducted, no oral arguments were made and no briefs were filed. Instead, the Commission issued its Final Order on July 31, 1997 adopting, in toto, the rates recommended by Staff in a contemporaneously filed report to the Commission.

The truncated procedure by which the Commission adopted "permanent" rates stands in sharp contrast to that of the initial arbitration proceeding. There, 2522 pages of prefiled

---

[11]Response of Southwestern Bell Telephone Company to Joint Application for Rehearing of MCI Telecommunications Corporation and Its Affiliates Including MCImetro Access Transmission Services, Inc. and AT&T Communications of the Southwest, Case Nos. TO-97-40 and TO-97-67, filed February 13, 1997, at pp. 1-2.

testimony and exhibits were submitted by 33 witnesses. Hearings were held for two weeks during which those witnesses were extensively cross-examined, resulting in a 1,782 page written transcript. And a series of briefs, reply briefs and cross motions were filed by each party. While Southwestern Bell has substantive and procedural due process concerns with certain aspects of the process the Commission used in making its determinations in the Initial Order,[12] the traditional administrative adjudicatory hearing conducted by the Commission there at least initially afforded the parties an opportunity to be heard on the record. The record supporting the "permanent" rates in the Final Order, however, is hauntingly silent.

I. THE PROCESS USED TO ADOPT THE FINAL ORDER VIOLATED MISSOURI AND UNITED STATES CONSTITUTIONAL DUE PROCESS REQUIREMENTS, AND STATE AND FEDERAL ADMINISTRATIVE AND ARBITRATION PROCEDURAL REQUIREMENTS.

The Commission is required to conduct its proceedings in a manner consistent with the requirements of due process mandated by Article I, Section 10 of the Missouri Constitution and the Fourteenth Amendment to the United States Constitution. But it failed to do so. Further, while it is not apparent from the FTA whether Federal or State administrative process rules apply, the process adopted by the Commission does not comport with either Federal or State administrative or arbitration procedure requirements. Regardless of which set of administrative or arbitration rules apply to interconnection rate arbitrations under the FTA, all require notice and a hearing before rates can lawfully be adjudicated.

---

[12]For a general description of these concerns, see, e.g., Southwestern Bell Telephone Company's Motion for Clarification, Modification and Rehearing of Arbitration Order, Case Nos. TO-97-40 and TO-97-67, filed December 20, 1996, pp. 1-9. More specific concerns with respect to each contested issue are set out in more detail in the subsequent pages of that Motion.

A. The Commission's Irregular Procedure Contravenes the Parties' Due Process Rights Guaranteed by the U.S. and Missouri Constitutions.

Whether the Commission is acting as an arbitrator or otherwise, it is a state agency that must comply with the requirements of due process mandated by Article I, Sec. 10 of the Missouri Constitution and the Fourteenth Amendment to the United States Constitution. See Elmore v. Chicago & Illinois Midland Ry., 782 F.2d 94, 96 (7th Cir. 1986). Accordingly, the rules governing the conduct of private, voluntary arbitration proceedings must be supplemented to the extent necessary to satisfy procedural due process.

At a minimum, due process requires in a proceeding of this type that the "parties be afforded a full and fair hearing at a meaningful time and in a meaningful manner." State ex rel. Fischer v. Public Service Commission, 645 S.W.2d 39, 43 (Mo. App. 1982). An "essential principle of due process is that a deprivation of life, liberty or property be preceded by notice and opportunity for hearing appropriate to the nature of the case." Cleveland Bd. of Ed. v. Loudermill, 470 U.S. 532, 542 (1985) quoting Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 313 (1950) (emphasis supplied). The Supreme Court has described "the root requirement" of the Due Process Clause as being "that an individual be given an opportunity for a hearing before he is deprived of any significant property interest." Id., at p. 542 quoting Bobbie v. Connecticut, 401 U.S. 371, 379 (1971) (emphasis in original).

The absence of any hearing on the issues in this proceeding obviously fails to satisfy this minimum standard. State ex rel. Chicago, R.I.& P.R.R. v. Public Service Commission, 355 S.W.2d 45, 52 (Mo. banc 1962). The Commission's reliance on evidence gathered ex parte by the Commission's Staff without providing any party an opportunity to offer its own proposals and

evidence, or to object to the proposals ultimately accepted, denies to the parties the right to a meaningful hearing. As the United States Supreme Court stated in Morgan v. United States, 304 U.S. 1 (1938): "a case in which [an agency] accepts and makes as [its] own the findings which have been prepared by the active prosecutors for the Government after an ex parte discussion with them and without according any reasonable opportunity to the respondents in the proceeding to know the claims thus presented and to contest them...is more than an irregularity in practice; it is a vital defect." See also Ohio Bell Tel. Co. V. Public Utilities Commission, 301 U.S. 292 (1937) (reliance on evidence not placed on record and not subject to scrutiny by affected parties violates fundamental requirements of due process); United Food & Commercial Workers International Union, AFL-CIO v. SIPCO., Inc., 1992 U.S. Dist. LEXIS 21332, at *29 (S.D. Iowa 1992), aff'd 8 F.3d 10 (8th Cir. 1993) (arbitrator's reliance on ex parte evidence without "opportunity to examine, object to, and cross-examine the evidence on grounds of relevance and accuracy" deprived parties of their right to a fair hearing); Totem Marine Tug & Barge, Inc. v. North American Towing, 607 F.2d 649, 651 (5th Cir. 1979) (same).

Moreover, it is clear that the procedures employed in this proceeding fail to satisfy the requirements of due process as articulated in the United States Supreme Court's decision in Matthews v. Eldridge, 424 U.S. 319 (1976). The nature of the parties' interests and the grave risk of error inherent in the Commission's reliance on ex parte evidence in this complex proceeding clearly lead to the conclusion that the parties were not afforded the process due them under the Missouri Constitution and the United States Constitution.

The Commission's providing twenty days for the parties to file for reconsideration does not remedy these serious constitutional and administrative defects. Reconsideration after a

decision is rendered is not a substitute for a pre-decision hearing when one is otherwise required. Cleveland Bd. of Ed. 470 U.S. at pp. 545-546 (full post-termination hearing does not cure Board's failure to give employee constitutionally-required pretermination hearing); Beatrice Foods v. New England Printing, 899 F.2d 1171, 1177 (Fed. Cir. 1990) (vacating sanctions imposed without hearing even though court rules provided an opportunity to move for reconsideration). Accord, Hathcock v. Navistar Intern. Transp. Corp., 53 F.3d 36, 42 (4th Cir. 1995).

B. The Commission Failed to Comply with its Own Procedural Orders.

In its January 22, 1997 Reconsideration Order, the Commission set forth a schedule and procedures for the conduct of proceedings to establish permanent rates. The schedule and procedures provided an opportunity for the parties to comment on any permanent rates proposed by the Commission. The Order also provided that the Commission "will conduct an on-the-record proceeding to allow statements from the parties" should such a proceeding be necessary.[13] These procedures, adjusted to extend the time at which the Commission would propose permanent rates, were reaffirmed by the Commission in its June 9, 1997 Notice Regarding Schedule for Development of Permanent Rates. The Commission, however, issued its July 31, 1997 Final Order without complying with its own procedural orders.

The Commission's failure to abide by its own procedural orders without notice to the parties or adequate explanation in the record is arbitrary and capricious and an abuse of discretion, substantially prejudicing the rights of the parties to this proceeding. (See, Gardner v Federal Communications Commission, 530 F.2d 1086, 1089-90 (D.C. Cir. 1976) (agency abused

[13]Reconsideration Order, pp. 9-10.

its discretion by upsetting reasonable expectation of party when it departed from its own previously announced procedure). The Commission's stated reason for this departure -- avoiding further delay -- is neither adequate nor reasonable. Given the Commission's prior establishment of interim rates, there simply is no need to rush to judgment on permanent rates at the expense of the parties' reasonable reliance on the Commission's adherence to its own procedural orders.

Moreover, the complexity of the issues raised in this proceeding, repeatedly acknowledged by the Commission, underscores the necessity and appropriateness of strict adherence to the Commission's initial procedural orders, including notice to the parties of the evidence on which the Commission relies for its permanent rates and an opportunity for the parties to explain and/or test such evidence, through cross-examination or otherwise, and to introduce additional evidence and argument if necessary. The nature of the issues simply is not appropriate for resolution on the basis of ex parte submissions without benefit of a hearing and argument.

C. The Commission's Failure to Follow its Own Procedural Orders Violated Sections 386.410 and 386.420.1 RSMo.

The Commission's failure to observe its own procedural orders also violates Section 386.410 RSMo (1994), which requires that "[a]ll hearings before the Commission . . . shall be governed by rules to be adopted and prescribed by the commission." The proceeding is not consistent with the requirements of 4 CSR 240-2.110. Nor was the Final Order adopted in compliance with the requirements of Section 386.420.1 which entitles the parties to this arbitration the right to be heard and to present evidence.

D. The Commission's Failure to Follow Contested Case Procedures Violated the Missouri Administrative Procedure Act.

The Commission's Final Order is unlawful because it was issued without observing the procedural requirements of the Missouri Administrative Procedure Act (MAPA), RSMo, Ch. 536. While the Commission's jurisdiction over this proceeding arises under Section 252 of the FTA, 47 U.S.C. Section 252, that legislation neither mandates particular procedures to be followed by the Commission nor preempts, expressly or by implication, otherwise applicable procedural requirements mandated by state law. (See 47 U.S.C. Section 252(e)(3)). The Commission itself has acknowledged that state procedural law applies to this proceeding in that it has allowed the Office of the Public Counsel to participate in this proceeding as required by Section 386.710 RSMo (1994).[14]

As an agency of the state within the meaning of Section 536.010(1) RSMo (1994), the Commission is subject to the requirements of the MAPA. See State ex rel. St. Louis Public Service Co. v. Public Service Commission, 365 Mo. 1032, 291 S.W.2d 95, 98 (Mo. banc 1956); State ex. rel Fischer v. Public Service Commission, 645 S.W.2d 39, 42 n.3 (Mo. App. 1982). As explained in State ex rel. Monsanto Company v. Public Service Commission, 716 S.W.2d 791, 796 (Mo. 1986): "The Public Service Commission is a creature of statute and can function only in accordance with statutes. Where a procedure before the Commission is prescribed by statute, that procedure must be followed."

The MAPA mandates extensive procedures governing any contested case. See, Sections 536,063, 536.067, 536,070, 536,073, 536.077, 536.070, 536.090 RSMo (1994). This proceeding

[14]Initial Order, p. 4.

is a "proceeding before an agency in which legal rights, duties or privileges of specific parties are required by law to be determined after hearing," Section 536.010(2) RSMo (1994), and thus, is a "contested case" with the meaning of the MAPA. As explained by the Missouri Supreme Court in State ex rel Yarber v. McHenry, 915 S.W.2d 325, 328 (Mo. 1995), if any proceeding before any agency involves issues in which a hearing is mandated by law, including "any statute or ordinance, or any provision of the state or federal constitutions" that hearing "must be conducted according to contested case procedures." Clearly, a proceeding involving the establishment of permanent rates or terms of service, a hearing is mandated by several sources of law including, but not limited to, Section 252 of the FTA, Sections 386.410 and 386.420 RSMo, Article I, Section 10 of the Missouri Constitution, and Section 1 of the Fourteenth Amendment to the U.S. Constitution. See State ex rel. Chicago, R.I. & P.R.R. v. Public Service Commission, 355 S.W.2d 45, 52 (Mo. banc 1962); State ex rel. Fischer v. Public Service Commission, 645 S.W.2d 39, 42-44 (Mo. App. 1982); Morgan v. United States, 304 U.S. 1 (1938); Ohio Bell Telephone Company v. Public Utilities Commission, 301 U.S. 292 (1937); Interstate Commerce Commission v. Louisville & Nashville R. Co., 227 US. 88 (1913).

The Commission plainly failed to comply with the MAPA's requirements governing contested cases by, inter alia, failing to conduct a hearing, depriving the parties of an opportunity to examine the evidence upon which the Commission relied for its order, failing to provide an opportunity to the parties to present evidence and cross-examine opposing witnesses, and failing to provide an opportunity for the parties to submit briefs and argument. Accordingly the Commission's Final Order is unlawful.

E. The Commission's Procedure Violated the Missouri Uniform Arbitration Act and the Federal Arbitration Act Which Provides the Right to Be Heard, Present Evidence and Cross-Examine Witnesses.

Even if it should be determined that the statutory procedures described above are inapplicable to this proceeding, the Final Order is nonetheless unlawful for failing to comply with appropriate procedural requirements. The Commission's procedures exceeded the Commission's powers because such procedures violate the requirements of the Missouri Uniform Arbitration Act, Section 435.370 RSMo (1994). That section provides the parties to an arbitration with a right to a hearing in which "[the parties are entitled to be heard, to present evidence material to the controversy and to cross-examine witnesses appearing at the hearing." Moreover, the Commission's failure to conduct the proceedings in a manner consistent with these requirements substantially prejudiced the rights of Southwestern Bell within the meaning of Section 435.405(4) RSMo (1994).

The Federal Arbitration Act similarly requires a hearing. Under 9 U. S.C. Section 10(a)(3), awards are to be set aside when, inter alia, the arbitrators are "guilty of misconduct . . in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced." Parties to an arbitration are entitled to a full and fair hearing on the merits, and the courts will not hesitate to overturn an award when such rights are violated. See, e.g, Korikar Maritime Enterprises S.A. v. Compagnie Belge D'Affretement, 668 F.Supp. 267, 271 (S.D.N.Y. 1987); Petrol Corp. V. Groupement D'Achat Des Carburents, 84 F.Supp. 446, 448 (D.C.N.Y. 1949).

II. THE TELRIC METHODOLOGY VIOLATES SECTION 252(d)(1) AND WORKS AN UNLAWFUL TAKING.

The plain text of the FTA makes clear that Southwestern Bell is entitled to recoup the "cost . . . of providing" interconnection and unbundled elements to its competitors, as well as the opportunity to obtain a reasonable profit for the use of its facilities. 47 U.S.C. Section 252(d).

The Final Order, however, bases permanent rates for these services and facilities on some of the hypothetical costs of operating an imaginary network composed exclusively of state-of-the-art facilities, instead of all of the actual costs of running Southwestern Bell's real-world network. The Staff Report states:

> Staff believes the most appropriate cost standard is the use of forward-looking economic costs assuming the existing network were being rebuilt today to meet forward-looking levels of demand. The approach includes the use of the latest technology currently deployed in the existing network...Staff believes this costing standard will most closely resemble the costs that an efficient competitor would face if entering the market today.[15]

This approach not only ignores the Act's plain text, but it also lacks a foundation under any rate-making statute or other authority. There are two separate infirmities: First, it completely ignores Southwestern Bell's actual booked or embedded costs of providing the interconnections and facilities requested by AT&T and MCI. Second, even if use of a forward-looking cost method like TELRIC is proper in this context -- which it is not -- the forward-looking costs the Commission used to determine price were inappropriate. The Commission did not simply decide that Southwestern Bell's rates should be based on the company's forward-looking costs (as opposed to its booked costs). Rather, it concluded that those rates should be based on the

---

[15]Final Order, Attachment C, p. 3.

forward-looking costs of operating an imaginary network that uses only the best, most efficient technology available. That is no different than requiring General Motors to make its existing automotive plants available to Ford and Chrysler at prices that reflect only the costs of operating the most up-to-date manufacturing operation. Neither the Staff Report nor the Final Order explain why it is appropriate to charge MCI and AT&T what it would cost them to build a fully modern and hyper-efficient network when Southwestern Bell's actual network costs more. It is not only inappropriate, it is unlawful.

A. The Commission Improperly Ignored Southwestern Bell's Actual Booked Costs to Provide the Requested Facilities.

No interpretation of a statute, not even an agency's, is entitled to deference "when it goes beyond the meaning that the statute can bear." MCI Telecomm. Inc. v. AT&T, 114 S.Ct. 2223, 2231 (1994). Based on its adoption of the Staff's proposed rates, the Commission obviously interpreted the Section 252(d)(1) pricing standard to permit it to ignore the actual booked costs incurred by Southwestern Bell to provide the interconnection and unbundled elements AT&T and MCI requested. This interpretation goes beyond the meaning Section 252(d)(1) can bear.

The pricing standard in Section 252(d)(1) is clear and straightforward: rates set in arbitrations "shall be based on the cost . . . of providing" the interconnection or unbundled network element at issue.[16] Southwestern Bell maintains that the reference to "cost" in Section

---

[16]The ellipses reflect omission of the parenthetical phrase "determined without reference to a rate-of-return or other rate-based proceeding." As the FCC explained, that language specifies "a type of proceeding that may not be employed to determine the cost of interconnection and unbundled network elements" but does not define "the type of costs that may be considered." (Interconnection Order, para. 704). That language simply demonstrates Congress' evident concern that rates be determined promptly, without the "costs and administrative burdens" of a lengthy rate case." (Ibid).